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SUBJECT: BOLIVIA: MINING SECTOR THREATENED

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Summary  
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¶1. (C) In the controversy following the ruling Movement Toward Socialism's (MAS) possibly-illegal initial approval of a draft constitution on November 26, there has been little attention given to the passage through Congress of a new mining tax bill on November 23. Neither the draft constitution nor the mining tax bill have been officially published, but we have received credible copies from various contacts. The mining tax bill is almost identical to the drafts reviewed in previous cables: a system of royalties is instituted, the royalties are not creditable against income tax at current prices, and an additional 12.5 percent income tax is added. The draft constitution, should it become official as currently written, would have serious consequences for U.S mining interests in Bolivia and would likely to discourage international investors. There is one ray of hope in that our contacts tell us that the CEDEIMS import tax recovery regime is likely to continue unchanged, where previously the government had threatened to eliminate it for companies not producing a metallic product (among major U.S. interests, only Apex's San Cristobal would have been affected.) However, the overall situation in the mining sector in Bolivia seems to be deteriorating, with increasing conflicts and violence at a number of small operations and a generally poor environment for investment. End summary.

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San Cristobal: Largest Investment in Bolivia Hit Hard  
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¶2. (C) In a meeting with the Charge and Ecopoloffs December

5, Apex Senior Vice President Jerry Danni and San Cristobal (Apex's Bolivian subsidiary) executives discussed the impact of the new tax law on their mine, the largest capital investment in Bolivia. According to Danni, with a government take of over 80 percent, Apex is now "working for the Bolivian government instead of for our shareholders." He added that, under the current tax regime, Apex would not have invested one billion dollars in Bolivia. Apex continues to be unable to arrange meetings (or even get responses) from the Mining Ministry and other Bolivian officials, and they report that Sumitomo (35 percent owner of San Cristobal) is equally shut out.

13. (C) In an attempt to gain some influence, and recognizing that the United States currently has little to offer that Evo's government seems to want, Apex is also continuing their lobbying efforts on ATPDEA. Danni informed us that they have hired the Livingston Group and have met recently with Bolivian Ambassador Guzman. Apex is hoping that help on ATPDEA will lead the government to provide tax relief, but at the same time Apex wants it subtly known that, should Apex get no cooperation, it will consider opposing ATPDEA. Overall, Danni and the local San Cristobal executives said that the new tax regime is "the end of investment in mining in Bolivia" and the new constitution, should it pass as currently drafted, "will be the end of private mining in Bolivia." Many other contacts in the mining industry share this bleak assessment.

14. (C) San Cristobal is currently meeting with low-level officials in the Ministry of Finance to lobby for a change in Bolivian tax laws that would let them deduct their hedge costs. They are also hoping for a change in the Bolivian tax law that would eliminate the 25 percent "excess profits surtax" or windfall tax: this surtax kicks in when profits exceed a certain level (the surtax is included in the estimate of an 85 percent government take.) Currently only San Cristobal and possibly the proposed Jindal Mutun operation would be subject to this surtax. In what Danni describes as a reaction to the new tax law and the overall perceived political instability in Bolivia, Apex's share price has four to five dollars per share in the past weeks.

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Constitution Disillusion  
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15. (C) The remains confusion over which draft of the MAS-backed constitution is the right one, and any draft is still subject to review and change, therefore a number of our industry contacts are withholding judgment on the drastic changes to the mining sector that would follow should the MAS draft constitution enter into force. There are, however, reasons for concern. Certain sections of the draft constitution reflect rumors that had been circulating in the mining sector regarding details of a new mining code: in particular, a requirement for all mining operations to sign joint venture agreements with the state mining company COMIBOL. Under article 349 (Natural Resources), "the state, through public, social or community entities, will assume control and direction over exploration, exploitation, industrialization, transportation and marketing of natural resources. The state will be able to sign joint venture contracts with legal entities, Bolivian or foreign, for the development of natural resources."

16. (C) In article 318, the draft constitution lays out rules for foreign investment in Bolivia: "Bolivian investment will be prioritized over foreign investment. All foreign investment will be subject to Bolivian jurisdiction, laws and authorities, and no one will be able to invoke exceptions or diplomatic claims to obtain more favorable treatment...The state is independent in all decisions of internal economic policy and will not accept impositions or conditions on this policy on the part of states, banks, or financial institutions, Bolivian or foreign, multilateral entities nor transnational companies." Article 355 states that private companies will not be able to list reserves as corporate

assets, even if they have the concessions from the government.

17. (C) The draft constitution contains what seems to be broad land rights for indigenous individuals and groups and rights to "share the benefits" of resources on that land. The mining sector does not need to wait to see what will happen with the draft constitution, however: on November 7, President Morales signed into law the UN Declaration on the Rights of Indigenous Peoples, which provides even greater basis for indigenous land claims. The section of the UN Declaration (now Bolivian Law No. 3760) that refers to provision of lands and resources seems to recognize indigenous rights to lands that they have historically occupied. This provision could result in endless land disputes in the mining sector (and elsewhere), considering that before the arrival of the Spanish all of Bolivia was to some extent occupied by indigenous people, and also considering that the majority of Bolivians currently self-identify as indigenous (depending on the survey.)

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Cooperativists Not Cooperative on Constitution  
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18. (C) Although the cooperativist miners (social groups with special status under Bolivian law), supported the MAS and President Morales during his campaign, relations have soured and the new constitution has further alienated the groups. Approximately five-hundred former Huanuni cooperativists, unemployed for almost a year since the nationalization of the Huanuni deposit, marched on Sucre on November 30 to reject the draft constitution, expressing their "unconditional support to the city of Sucre" and criticizing that "the legal process was not respected by the government in the vote on the (draft) constitution." The broad rights given to indigenous groups under the draft constitution have prompted cooperativist ire, particularly since the promulgation of law 3760 based on the UN Declaration comes in the wake of a number of recent mine invasions by local communities. Currently there are dozens of cases of indigenous or campesino groups taking over small mines by force, claiming an indigenous right to the land, and in at least one case, a number of deaths have been reported.

19. (C) Some of the cases involve small private mines: for example, an Argentine and Brazilian couple have filed for assistance with the Bolivian government after local campesinos (indigenous farmers) invaded their mine and reportedly forced them to sign over the mine and their house "under the recent UN Declaration of Indigenous Rights." An embassy contact who manages a small private mine that has been taken by local campesinos recently outlined to emboff his plans to hire "miners" who are more known for their ability to fight than mine. The mine manager explained that the police are not interested in getting involved and that frontier law is in effect. The Mining Ministry lists eleven cases of private mines being taken by local communities and eight official complaints from cooperativist miners. The Mining Ministry's policy is to try to arrange meetings to reconcile differences, a tactic that has not been productive, and violent confrontations between miners and indigenous communities are occurring with greater frequency. The threat of more indigenous "takings" of cooperative mines has turned the cooperativists against the draft constitution and, to some extent, against the MAS.

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Death (of investment) and Taxes  
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10. (C) The mining tax bill has not been substantially changed in any way that will help U.S. companies, although there does seem to be a small concession which will assist Newmont's Inti Raymi operations (specifically giving more-favorable royalty rates for gold coming from "marginal mines and sulfurous minerals requiring high technology.") Otherwise, the new law includes all of the points that we

have reported on before, including a new 12.5 percent additional tax on top of the current income tax. Companies which produce "value added products" (that is, metals rather than concentrates) will only have to pay 60 percent of the additional 12.5 percent income tax (note: of large U.S. operations, only San Cristobal produces concentrates, and therefore only San Cristobal will pay the full 12.5 percent additional rate. End note.) The 12.5 percent additional income tax rate will be applied when the mineral prices are above the levels set for calculating royalties: currently all metal prices are above those levels and therefore the 12.5 percent increase in income tax will be effective immediately.

¶11. (C) The new royalties are calculated on a 3-tiered system based on mineral price (for example, for silver there is a 6 percent royalty when prices are over 8 USD per troy ounce, 0.75 percent times the price when the price is between 4 and 8 USD per troy ounce, and 3 percent when the price is less than 4 USD per troy ounce. The tiered prices have been set so that, currently, all royalties will be charged at the highest level possible.) The new royalties will be creditable against income tax only when mineral prices are below certain levels (again, these levels are far below current market prices, meaning that for now and in the foreseeable future, companies will not be able to credit their royalties against their income tax and will instead have to pay both.) Royalties are deductible when not creditable. (Note: One noticeable change in the tax law is that the numerical price level for crediting royalties on iron is now much lower than it was in previous drafts, so that royalties on iron will also not be creditable at current market prices. This change could have a negative impact on the viability of the Jindal Mutun project, although our contacts in the Honorary Indian Consulate do not seem concerned. End note.)

¶12. (C) Overall, these changes convert Bolivia from a country with a relatively attractive mining tax regime into the country with one of the highest tax rates in the region. A number of our contacts have pointed out that, with Bolivia's instability and infrastructural limitations, international mining companies are avoiding Bolivia in favor of nearby countries. Having lost any tax advantages it once had, Bolivia now holds even less appeal for international investors. Apex's Jerry Danni pointed out that, with the passage of the new tax law, international interest in investment in the Bolivian mining sector has been basically eliminated, while investment in neighboring countries is booming. Danni and local San Cristobal executives confirmed that the MAS are looking at the short term--what will get them more money and more votes in the next few months--and ignoring long-term effects as their actions drive away investment. Knowing that mines, by their nature, can't be moved and that U.S. companies have invested too much to pull out, the MAS intend to wring every last penny possible out of them, regardless of what this may do for Bolivia's reputation in the mining industry.

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Slightly Tarnished Silver Lining  
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¶13. (C) According to sources in the mining sector, the Congress will soon approve a bill which will leave the CEDEIMS import tax recovery program unchanged. Previously, the Bolivian government had proposed a change to the CEDEIMS program which would have meant that only companies producing "value added" products (metals instead of concentrate) would be allowed to claim their import taxes against export taxes. This change would, again, have affected only Apex's San Cristobal mine among large U.S. operations. Currently, San Cristobal executives and the president of Bolivia's national "Medium Miners Association" believe that the Senate and the President will sign the new bill leaving CEDEIMS unchanged, to the benefit of San Cristobal.

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¶14. (C) Apex and local U.S. mining executives view the public welcoming of the new tax law by U.S. Coeur D'Alene executives as a strange aberration, and local Couer executives confess privately to us that the new tax law is, in fact, bad for Coeur. Although the higher taxes are not good for any international operation, the increased taxes fall disproportionately on Apex's San Cristobal mine. The Ambassador has advocated for U.S. mining interests in the past, calling on Vice President Garcia Linera and other officials to try to protect U.S. investments in the sector. Recent government actions and statements have shown, however, that the MAS-led government is not interested in the concerns of international mining investors. During the Ambassador's recent visit to Coeur D'Alene's San Bartolome operation, scheduled to begin production in 2008, Coeur's South American Operations President Jim Duff was asked about the situation in the Bolivian mining sector. Duff replied that, considering the investment climate under the new government and increasingly strained relations with local communities, if Coeur had to decide today, they would not invest in Bolivia. Apex Vice President Jerry Danni echoed this sentiment, saying, "we certainly wouldn't have built a one billion dollar project here under the current parameters."

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